



Treasury Trends

Bringing currency to the Arizona Taxpayer

David A. Petersen, State Treasurer

September 2004

Volume 2, Number 9

This month's
character trait ---

Decisiveness:
*The ability to
recognize key
factors and finalize
difficult decisions*

**Both LGIP Pools
continue to
increase their
yields in
August 2004**

Minh Trang to:

*** help establish
new pools,**

*** assist LGIP
participants in
structuring
portfolios, and**

*** increase
communication
with LGIP
participants.**

LGIP Performance

The Board of Investment, in the regular meeting held on September 15, 2004, was informed of the performance of the LGIP and LGIP-Gov pools. Both pools continued to increase their yields over the previous month. Balances of the pools also remained relatively stable for the month.

Yields	LGIP	LGIP Index	Diff	LGIP-GOV	3 mo. T-Bill	Diff
Pool size →	\$2.4 B			\$1.1 B		
January '04	1.41	.85	+.56	.98	.89	+.09
Feb '04	1.44	.85	+.59	1.00	.93	+.07
March '04	1.39	.84	+.55	1.01	.95	+.06
April '04	1.39	.84	+.55	1.02	.95	+.07
May '04	1.39	.84	+.55	1.01	1.03	-.02
June '04	1.45	.88	+.57	1.06	1.26	-.20
July '04	1.59	1.03	+.56	1.25	1.34	-.09
August '04	1.72	1.20	+.52	1.39	1.49	-.10
September '03	1.48	.83	+.65	.97	.95	+.02
October '03	1.43	.83	+.60	.97	.93	+.04
November '03	1.43	.85	+.58	.99	.94	+.05
December '03	1.44	.88	+.56	.98	.90	+.08

New Trader / LGIP Outreach Coordinator Hired

The Arizona State Treasurer's Office (ASTO) is excited to report the hiring of a new trader who will be the LGIP outreach coordinator. Mr. Minh Trang will work to provide increased service to LGIP participants and to bring the two new LGIP pools to fruition. He will be a resource for LGIP participants in structuring the four LGIP alternatives into a plan to meet cash-flow/yield objectives. Minh comes to the ASTO from Stone & Youngberg, where he worked closely with institutional investors in building portfolios. He is also pursuing the final exam for the CFA designation.

The two new pools will be longer in duration than the existing LGIP pools. The goals will be to enhance yield (through a dynamic asset allocation structure) while maintaining a high level of credit safety. These pools will offer LGIP members an opportunity to diversify investments. You will see more details in the coming weeks.

Rising oil prices usually cause rising long-term interest rates. Currently, the opposite is true.

Increasing economic activity helping State revenues

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Nationwide Perspective

Oil and Bond prices in unique correlation

Crude oil prices are reaching all-time high levels. High oil prices, historically, have led to inflation, which usually causes bonds to drop in price, raising interest rates. Then why are long bonds going up and short interest rates rising? This is an aberration to the historical relationship between oil and interest rates. The thinking seems to be that increased oil prices will pressure corporate profits because companies will be unable to pass on the increased costs due to competitive pressures. Lower profits result in slower growth, thus less inflation. Lower inflation means interest rates don't need to rise as high as originally anticipated. The salient question is, "how long will corporations be able to absorb higher costs without raising process?" Once rates start rising, the "cost-push" inflation will force interest rates higher.

Arizona Economy Improving

Financial results for Fiscal Year ("FY") 2004 for the State of Arizona were recently distributed by the Joint Legislative Budget Committee. The numbers for FY 2004 show an improving economy in Arizona.

Sales and use tax receipts, which comprise over half of State revenues, increased 8.6% over FY 2003. The "contracting" category was strong. "Use taxes" increased 22.4% due to increased prices and amounts of natural gas burned by Arizona power plants. The rising volume indicates an increased demand for power, probably due to accelerating economic activity.

Individual income taxes, contributing about 40% of State revenues, rose 13.6% when compared to FY 2003. This was likely due, in part, to the 53,600 jobs added to payrolls last year.

The biggest gainer was corporate income tax, over 7% of total state revenues, which climbed 26.9% from FY 2003 levels. Increased taxes by corporations indicate increasing profits. Should profits continue to increase, this portends an increase in capital expenditures and hiring by the corporate sector.

Overall, receipts from the "big three taxes" rose 10.4% in FY 2004. While State revenues are not at peak levels, they are definitely looking better than two years ago.

Yield Curve Perspective

Treasury Yield Curve				
Term	24 Sept	1 Week Earlier	1 Month Earlier	1 Year Earlier
3 mo.	1.72	1.69	1.53	0.93
6 mo.	1.98	1.90	1.79	1.01
2 yr.	2.57	2.47	2.45	1.60
3 yr.	2.84	2.78	2.85	2.08
5 yr.	3.32	3.33	3.45	3.05
10 yr.	4.03	4.11	4.27	4.13
30 yr.	4.80	4.91	5.06	5.03